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Reply to:  
Consumer Advocate and Protection Division  
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February 26, 2003

Chairman Sara Kyle  
Tennessee Regulatory Authority  
460 James Robertson Parkway  
Nashville, Tennessee 37243

**RE: In Re: Small Telephone Companies Tariff Filings Regarding Reclassification  
of Pay Telephone Service as Required by Federal Communications  
Commission, FCC Docket 96-128  
Docket No. ~~01-001181~~ 97-01181**

Dear Chairman Kyle:

Enclosed is an original and thirteen copies of the Attorney General's Supplemental Brief Concerning Cost-Based Rates and Removal of Subsidies Pursuant to 47 U.S.C. § 276(b)(1)(B) for filing in the above-referenced matter. If you have any questions, kindly contact me at (615) 532-3382. Thank you.

Sincerely,

A handwritten signature in cursive script that reads "Shilina B. Chatterjee".

Shilina B. Chatterjee  
Assistant Attorney General

SBC  
Enclosures

**BEFORE THE TENNESSEE REGULATORY AUTHORITY  
AT NASHVILLE, TENNESSEE**

IN RE: SMALL TELEPHONE  
COMPANIES TARIFF FILINGS  
REGARDING RECLASSIFICATION  
OF PAY TELEPHONE SERVICE AS  
REQUIRED BY FEDERAL  
COMMUNICATIONS COMMISSION  
FCC Docket 96-128

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Docket 97-01181

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**ATTORNEY GENERAL'S SUPPLEMENTAL BRIEF CONCERNING COST-BASED  
RATES AND REMOVAL OF SUBSIDIES PURSUANT TO 47 U.S.C. § 276(b)(1)(B)**

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The Attorney General's Office, through the Consumer Advocate and Protection Division ("Attorney General"), participates as an intervener in this matter before the Tennessee Regulatory Authority ("TRA").

The Attorney General submits this brief in response to the TRA's request that the parties file briefs addressing: (1) whether §276(b)(1)(B) requires cost-based rates and (2) whether previous actions of the TRA removing subsidies satisfied the requirements of §276(b)(1)(B).

**STATEMENT OF FACTS**

Section 276 of the Federal Telecommunications Act of 1996 (the "Act") mandated that the Federal Communications Commission promulgate rules to require all telephone companies to file tariffs in order to reclassify payphones and remove subsidies to payphone operations from other classes of services.<sup>1</sup> The FCC rules provided that state regulatory agencies were to execute

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<sup>1</sup> See *Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996*, CC Docket No. 96-128, FCC Docket No. 96-388, 11 FCC Rcd 20,541 (Sept. 20, 1996) ("Report and Order").

the FCC rules. Thereafter, the FCC issued several orders providing further clarification and explanation concerning Section 276.

In accordance with the FCC rules, payphone operators in Tennessee were required to file tariffs with the TRA. BellSouth and United Telephone Southeast, Inc. ("UTSE") filed their tariffs with the TRA followed by the other telephone companies. After the tariffs were filed, AT&T Communications of the South Central States ("AT&T"), Tennessee Payphone Owners Association ("TPOA"), MCI Telecommunications Corporation ("MCI") and the Attorney General filed respective petitions to intervene. At that point, the TRA began a contested case concerning the tariffs and also consolidated the dockets in order to proceed with one contested case (Docket No. 97-00409).

At the May 29, 1997 pre-hearing conference, the Attorney General requested that the TRA bifurcate Docket No. 97-00409 to have one proceeding for BellSouth, UTSE and Citizens and another proceeding for the small telephone companies. It was evident that the expense of preparing cost studies should be addressed. The pre-hearing officer agreed and granted the bifurcation of the proceeding to spare the small telephone companies the expense of preparing and filing cost studies. Thereafter, a docket was opened and the present proceeding assigned Docket No. 97-01181.

### **ARGUMENT**

#### **I. 47 U.S.C § 276(b)(1)(B) REQUIRES COST-BASED RATES BE USED FOR CALCULATING PAYPHONE LINE RATES PURSUANT TO FCC ORDERS**

In 1996, Congress enacted Section 276 and granted the FCC authority to promulgate rules in an effort to promote competition among payphone service providers and achieve a widespread

deployment of payphone services for the benefit of the general public.<sup>2</sup> The FCC issued rules and orders for payphones and required that state commissions assist them in implementing Section 276 for all payphones.<sup>3</sup> The FCC stated that enforcement of Section 276 is given to the state regulatory agencies and all telephone companies with payphones were required to file tariffs with the state commissions to reclassify the payphones and remove subsidies from payphone service.<sup>4</sup>

**A. The FCC Orders Concerning Reclassification of Payphones Consistently State that Cost-Based Rates Are Necessary in Order to Implement Section 276(b)(1)(B)**

Congress directed that payphones be reclassified and all subsidies be removed from all payphones.<sup>5</sup> The FCC concluded that in order to achieve this result, costs must be determined by an appropriate forward-looking, economic cost methodology consistent with the principles articulated in the Local Competition Order.<sup>6</sup> Based on the overall scheme of the Telecommunications Act of 1996, the FCC believed it was proper to use the same cost methodology for payphones. Previous FCC orders stated that the rates assessed by Local Exchange Carriers ("LECs") for payphone services tariffed at the state level should satisfy the

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<sup>2</sup> 47 U.S.C. § 276(b)(1).

<sup>3</sup> See *Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996*, CC Docket No. 96-128, FCC Docket No. 96-388, 11 FCC Rcd 20,541, ¶8 (Sept. 20, 1996) ("Report and Order").

<sup>4</sup> See *Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996*, CC Docket No. 96-128, FCC Docket No. 96-388, 11 FCC Rcd 20,541, ¶60 (Sept. 20, 1996) ("Report and Order").

<sup>5</sup> 47 U.S.C. § 276(b)(1)(B).

<sup>6</sup> See *In the Matter of the Local Competition Provisions of the Telecommunications Act of 1996*, CC Docket 96-98, First Report and Order, 11 FCC Rcd 15499 (Aug. 8, 1996) (Local Competition Order). See *In the Matter of Wisconsin Public Service Commission Order Directing Filings*, CCB/CPD No. 00-01, DA 00-347, Memorandum Opinion and Order (January 31, 2002), ¶2 ("Second Wisconsin Order").

new services test.<sup>7</sup> The new services test is a cost-based pricing methodology that sets the direct cost of providing the new service as the price floor, and then adds a reasonable amount of overhead cost to derive the price ceiling of the new service.<sup>8</sup>

In the beginning, the FCC was clear concerning Section 276. They required all the LECs' tariffs be cost-based. In their initial Report and Order<sup>9</sup> issued by the FCC on September 20, 1996 setting forth the guidelines and providing additional explanation of Section 276, they stated that all Local Exchange Carriers' payphone tariffs must be cost-based and nondiscriminatory.<sup>10</sup>

Even though the FCC refers to using the cost-based methodology with regard to BOCs in the Second Wisconsin Order<sup>11</sup>, they explained that they could not explicitly mandate that all LECs be required to use the new services test since Congress did not grant them jurisdiction over rates set by non-BOC LECs.<sup>12</sup> Nevertheless, they strongly encouraged the states to apply to all LECs the same cost-based requirement applied to BOCs in an effort to be consistent and effectively carry out the directives of Section 276.<sup>13</sup>

It is imperative that the TRA recognize that Section 276(b)(1)(B) requires that all LECS eliminate payphone subsidies. The plain language of Section 276(b)(1)(B) dictates application to

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<sup>7</sup> See *In the Matter of Wisconsin Public Service Commission Order Directing Filings*, CCB/CPD No. 00-01, DA 00-347, Memorandum Opinion and Order (January 31, 2002), ¶14 ("Second Wisconsin Order").

<sup>8</sup> See *In the Matter of Wisconsin Public Service Commission Order Directing Filings*, CCB/CPD No. 00-01, DA 00-347, Memorandum Opinion and Order (January 31, 2002), ¶12 ("Second Wisconsin Order").

<sup>9</sup> Order on Reconsideration, 11 FCC Rcd 21233, 21308 (1996).

<sup>10</sup> Second Report and Order, 13 FCC Rcd 1778 (1997), ¶ 2, citing Order on Reconsideration, 11 FCC Rcd 21233, 21308 (1996).

<sup>11</sup> *In the Matter of Wisconsin Public Service Commission Order Directing Filings*, CCB/CPD No. 00-01, DA 00-347, Memorandum Opinion and Order (January 31, 2002) ("Second Wisconsin Order").

<sup>13</sup> See *In the Matter of Wisconsin Public Service Commission Order Directing Filings*, CCB/CPD No. 00-01, DA 00-347, Memorandum Opinion and Order (January 31, 2002), ¶31 ("Second Wisconsin Order").

both intrastate and interstate subsidies. Section 276(b)(1)(B) states that the FCC shall take all actions necessary to prescribe regulations that

- (B) discontinue the intrastate and interstate carrier access charge payphone service elements and payments in effect on such date of enactment, and all intrastate and interstate payphone subsidies from basic exchange and exchange access revenues, in favor of a compensation plan as specified in subparagraph (A).

Also, the FCC specified that Section 276(b)(1)(B) is broader than other sections and “it applies to all LECs and is not limited to the BOCs.”<sup>14</sup> In a practical sense, use of cost-based rates is the best available means for eliminating payphone subsidies. Therefore, application of cost-based rates should be used for all LECs in accordance with Section 276. The FCC recommends that the states apply the new services test to all LECs in order to extend the pro-competitive regime intended by Congress to all payphones.<sup>15</sup>

It is essential that cost-based rates be applied to all LECs to ensure that the goals of Section 276 are satisfied. In paragraph 8 of the Report and Order, the FCC stated that to achieve the goals of Section 276, they must apply the rules and regulations to “to all the players in the industry” to allow for a competitive payphone industry.<sup>16</sup> The intent of Congress to promote an open and competitive market in the industry, as expressed in the Telecommunications Act of 1996, was the goal and mandate of the FCC. In placing uniform rules and regulations on the

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<sup>14</sup> See *In the Matter of Wisconsin Public Service Commission Order Directing Filings*, CCB/CPD No. 00-01, DA 00-347, Memorandum Opinion and Order (January 31, 2002), ¶34, FN 80 (“Second Wisconsin Order”).

<sup>15</sup> See *In the Matter of Wisconsin Public Service Commission Order Directing Filings*, CCB/CPD No. 00-01, DA 00-347, Memorandum Opinion and Order (January 31, 2002), ¶42 (“Second Wisconsin Order”).

<sup>16</sup> See *Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996*, CC Docket No. 96-128, FCC Docket No. 96-388, 11 FCC Rcd 20,541, & 8 (Sept. 20, 1996) (“Report and Order”).

industry as whole, without allowing for any exemptions, the FCC was promoting an equal playing field in the market for all carriers.

In the prior docket (Docket No. 97-00409), the TRA stated that Section 276 applies to all telephone carriers. On May 29, 1997, the TRA's hearing officer issued a Preliminary Report and Recommendation in Docket Number 97-00409 stating that Section 276 applied to all telephone carriers.<sup>17</sup> Thereafter, in the Interim Order, the TRA stated:

The FCC has indicated that the states must use the 'new services test' when establishing intrastate payphone rates pursuant to Section 276. The new services test creates a price floor equal to the direct or economic cost of providing a service, including a reasonable rate of return. Lastly, the rates established in this docket must be cost-based and non-discriminatory, which is consistent with the mandate of Section 276.<sup>18</sup>

Since the TRA has applied the cost-based methodology in the prior docket to other LECs, it should also be applied in this docket.

The small telephone companies may argue that the non-BOC LECs are relieved of the obligation to comply with 47 U.S.C. § 276 and not subject to cost-based rates because the FCC does not have jurisdiction over them, however, they are incorrect. Although the FCC only has authority over the BOC's, they have asked that the states assist them in implementing Section 276 for all LECs. The TRA is left with the duty of eliminating subsidies. While an alternative to cost-based rates may exist, reliance on cost-based rates still appears to be the only method of

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<sup>17</sup> See *Preliminary Report and Recommendation of the Hearing Officer, All Telephone Companies Tariff Filings Regarding Reclassification of Pay Telephone Service as Required by the Federal Communications Commission Docket 96-126, Docket 97-00409, May 29, 1997.*

<sup>18</sup> See *In Re: All Telephone Companies Tariff Filings Regarding Reclassification of Pay Telephone Service as Required by Federal Communications Commission (FCC) Docket 96-128, Interim Order, TRA Docket No. 97-00409, pp. 16-17 (February 1, 2001).*

satisfying the requirements of Section 276.

**B. The TRA Should Apply Cost-Based Methodology to the Payphone Rates of the Small Telephone Companies Pursuant to 47 U.S.C. § 276(b)(1)(B)**

Tennessee law grants the TRA broad general supervisory and regulatory authority over all telecommunication service providers. Tennessee Code Annotated § 65-4-201 states that the TRA has the “general supervisory and regulatory power, jurisdiction and control over all public utilities and also over their property, property rights, facilities, and franchises . . .”<sup>19</sup> The TRA has previously recognized that they have the authority to require small telephone companies to comply with Section 276 concerning payphones<sup>20</sup> and to establish the rates of payphones in the State of Tennessee.<sup>21</sup> Since the FCC mandated that the states assist them in effectuating the directives of Section 276, it is proper for the TRA to require the small telephone companies to use cost-based rates.

Finally, the FCC stated that nothing prevents the states from applying the new services test to all non-BOC LECs, whether rural or not, and stated that the states themselves can determine whether it is appropriate and warranted.<sup>22</sup> Based on the foregoing, the TRA should apply the cost-based methodology to the small telephone companies as it has previously done to the non-BOC LECs.

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<sup>19</sup> Tennessee Code Annotated § 65-4-201.

<sup>20</sup> See *In Re: All Telephone Companies Tariff Filings Regarding Reclassification of Pay Telephone Service as Required by Federal Communications Commission (FCC) Docket 96-128*, Final Order, TRA Docket No. 97-00409, pp. 1-2 (June 12, 2002) citing *In re Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996*, 11 F.C.C.R. 20,541 (Sept. 20, 1996) (“Report and Order”).

<sup>21</sup> Tennessee Code Annotated § 65-5-204 grants the TRA power “to fix just and reasonable individual rates, joint rates, tolls, fares, charges or schedules . . .” for all telephone companies.

<sup>22</sup> See *In the Matter of Wisconsin Public Service Commission Order Directing Filings*, CCB/CPD No. 00-01, DA 00-347, Memorandum Opinion and Order (January 31, 2002), ¶67 (“Second Wisconsin Order”).



## **II. PREVIOUS ACTIONS OF THE TRA REMOVING SUBSIDIES SATISFY THE REQUIREMENTS OF 47 U.S.C. § 276(b)(1)(B).**

Section 276 of the Act prohibits payphone rates from including subsidies to or from other telecommunications services and creating preferences to a LEC's payphone operation.<sup>23</sup> The TRA effectuated the goals in the prior docket concerning Section 276 (Docket Number 97-00409) concerning the removal of subsidies pursuant to Section 276(b)(1)(B). In that docket, the TRA acknowledged that Section 276 of the Act required LECs to remove any subsidies attributable to payphones from intrastate rates.<sup>24</sup> The TRA has reaffirmed that Section 276(b)(1)(B) prohibits subsidization of payphone rates and they have followed the FCC guidelines to remove all subsidies from payphones.

The TRA has treaded carefully and deliberately down the path that Congress and the FCC intended for the promotion of payphone competition. In the TRA's Interim Order in Docket 97-00409, the TRA formally adopted Section 276 and FCC requirements as policy.<sup>25</sup> The Authority determined (1) that the rates adopted by the TRA were to be applied to all providers of payphone service, (2) that the rates for payphones must be cost-based, non-discriminatory and consistent with the provisions of Section 276 and T.C.A. 65-5-208(c), (3) that payphone rates should include a monthly flat rate component and a usage rate component, and (4) that the methodology

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<sup>23</sup> See *In Re: All Telephone Companies Tariff Filings Regarding Reclassification of Pay Telephone Service as Required by Federal Communications Commission (FCC) Docket 96-128*, Interim Order, TRA Docket No. 97-00409, pp. 16-17 (February 1, 2001).

<sup>24</sup> See *In Re: All Telephone Companies Tariff Filings Regarding Reclassification of Pay Telephone Service as Required by Federal Communications Commission (FCC) Docket 96-128*, Interim Order, TRA Docket No. 97-00409, pp. 23-24 (February 1, 2001).

<sup>25</sup> See *In Re: All Telephone Companies Tariff Filings Regarding Reclassification of Pay Telephone Service as Required by Federal Communications Commission (FCC) Docket 96-128*, Interim Order, TRA Docket No. 97-00409, p. 2 (February 1, 2001).

used to calculate the cost-based rates would be the new services test which included cost, overhead expenses and a reasonable return.<sup>26</sup> Essentially, they implemented the goals of Section 276 and took the necessary steps to remove subsidies from payphone line rates.

Further, these requirements were imposed on the four largest telecommunications providers in Tennessee. Most importantly, three of these companies were non-BOC LECs and the TRA ordered them to use cost-based rates and remove all subsidies from their payphones. In that docket, the Directors found that under Section 276 the LECs were required to remove all subsidies for payphones.<sup>27</sup> They even voted unanimously to direct the LECs to correct their subsidy calculations to remove any subsidies.<sup>28</sup> In the Interim Order, the TRA stated that payphone rates should include a monthly flat rate component and a usage rate component.<sup>29</sup> They also adopted the new services test as the appropriate test to use in calculating payphone

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<sup>26</sup> See *In Re: All Telephone Companies Tariff Filings Regarding Reclassification of Pay Telephone Service as Required by Federal Communications Commission (FCC) Docket 96-128*, Final Order, TRA Docket No. 97-00409, p. 15 (June 12, 2002).

<sup>27</sup> See *In Re: All Telephone Companies Tariff Filings Regarding Reclassification of Pay Telephone Service as Required by Federal Communications Commission (FCC) Docket 96-128*, Interim Order, TRA Docket No. 97-00409, p. 24 (February 1, 2001).

<sup>28</sup> See *In Re: All Telephone Companies Tariff Filings Regarding Reclassification of Pay Telephone Service as Required by Federal Communications Commission (FCC) Docket 96-128*, Interim Order, TRA Docket No. 97-00409, p. 24 (February 1, 2001).

<sup>29</sup> See *In Re: All Telephone Companies Tariff Filings Regarding Reclassification of Pay Telephone Service as Required by Federal Communications Commission (FCC) Docket 96-128*, Interim Order, TRA Docket No. 97-00409, p. 28 (February 1, 2001).

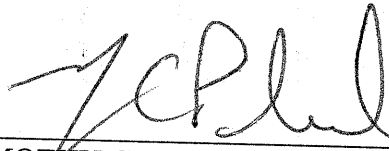
access line rates.<sup>28</sup> They held that “any rates calculated pursuant to the new services test must comply with Section 276 of the Act and state law.”<sup>29</sup> The TRA reviewed and decided the issue of subsidies in the prior docket (Docket No. 97-00409) in accordance with Section 276(b)(1)(B).

### CONCLUSION

For the foregoing reasons, the Attorney General of the State of Tennessee respectfully submits that Section 276 of the Telecommunications Act of 1996 requires cost-based rates for all payphone companies and that in Docket No. 97-00409, TRA satisfied the requirements of removing subsidies pursuant to of Section 276(b)(1)(B).

Respectfully submitted,

PAUL G. SUMMERS, B.P.R. # 6285  
Tennessee Attorney General

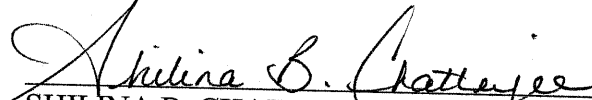


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<sup>28</sup> See *In Re: All Telephone Companies Tariff Filings Regarding Reclassification of Pay Telephone Service as Required by Federal Communications Commission (FCC) Docket 96-128*, Interim Order, TRA Docket No. 97-00409, pp. 28-29 (February 1, 2001).

<sup>29</sup> See *In Re: All Telephone Companies Tariff Filings Regarding Reclassification of Pay Telephone Service as Required by Federal Communications Commission (FCC) Docket 96-128*, Interim Order, TRA Docket No. 97-00409, p. 16 (February 1, 2001).

  
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Dated: February 26, 2003

## CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing was served via U.S. Mail, facsimile or hand delivery on February 26, 2003.

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